Future Residential Series

The evolution of Prime Central London

July 2021

CLUTTONS

Make more of your property

Introduction

Prime Central London (PCL) is not just an area you can draw on a map. It is a property market separate from the ordinary, representing the most desirable and valuable addresses in the capital. This appeal is partly due to fundamentals such as location, value, and the type and quality of buildings, but there are also less tangible characteristics that make it hard to fully define. These attributes have held firm for a long time, but the Coronavirus pandemic has led to dramatic changes in how we live and work. Some of those changes will be temporary and some permanent. Our new research looks at how these changes might alter the map of PCL.

This report is the first in our series of new research publications looking at the opportunities and challenges facing the UK's housing market. We start our series by focusing on PCL. This is a market that dominates the rest of the country when considering property prices and tax receipts. It has also tended to lead the housing market cycle and set trends for new development and aspirations. But recent years have been more challenging for PCL property, with a stagnant housing market that the pandemic has only exacerbated.

It also raises more difficult issues. PCL's expansion in recent decades has created challenges for more price conscious buyers and pushed them further afield. While the area is home to some of the wealthiest people in the world, it has an exceptionally unequal income distribution and for many people housing is seriously unaffordable. From these issues and trends, it is clear that to begin to understand the UK's housing market, it is essential to understand the housing market in PCL.

> Prime Central London has come a long way since it was fields filled with fairs, and marshes roamed by highwaymen.

Sophy Moffat
Head of research

Defining Prime Central London

There is no single definition of Prime Central London (PCL), and it continues to change and evolve depending on the demands and fashions of the time. PCL has seen huge change since it emerged from the fields and marshes of the 18th century. First came the Great Estates and exhibitions of the 19th century. Then followed the decline of the aristocracy and destruction of buildings in the early 20th century. More recent decades have seen the reinvention, expansion, and development of new neighbourhoods. This raises the question of what and where is PCL and how it might evolve in the future.

Defining PCL is not simple and there is no single definitive list. However, it is perhaps useful if we reduce it into its constituent parts. First, in reverse order, is London, one of a limited number of truly global cities that attracts buyers from across the world. Second is Central, which is relatively easy to define and reflects the proximity to the pleasures and profits of the West End and City. It is the final part, defining what constitutes prime property that is much more difficult.

Perhaps the most frequent way to define Prime is by reference to property prices, either by capital value or, more typically, by price per square foot. Alternatively, Prime could be defined by areas such as postcode districts, street by street, or any other geography. But it is not just the location or the price, it is also the type and quality of property that matters. For example, the period houses on a street might be considered prime but the flat above the shop on the corner may not be. Ultimately what is prime will depend on the preferences of any given buyer and one person's prime might not be another buyer's cup of tea.

Given these challenges, it is perhaps easiest to say which areas are PCL and which areas are not. What is harder is to define are the areas that fall somewhere in-between. For example, Earls Court (SW5), was historically excluded from definitions of PCL thanks to its backpackers and cheap hotels. Most of those have moved further afield and SW5's garden squares have helped push average values well into PCL territory.

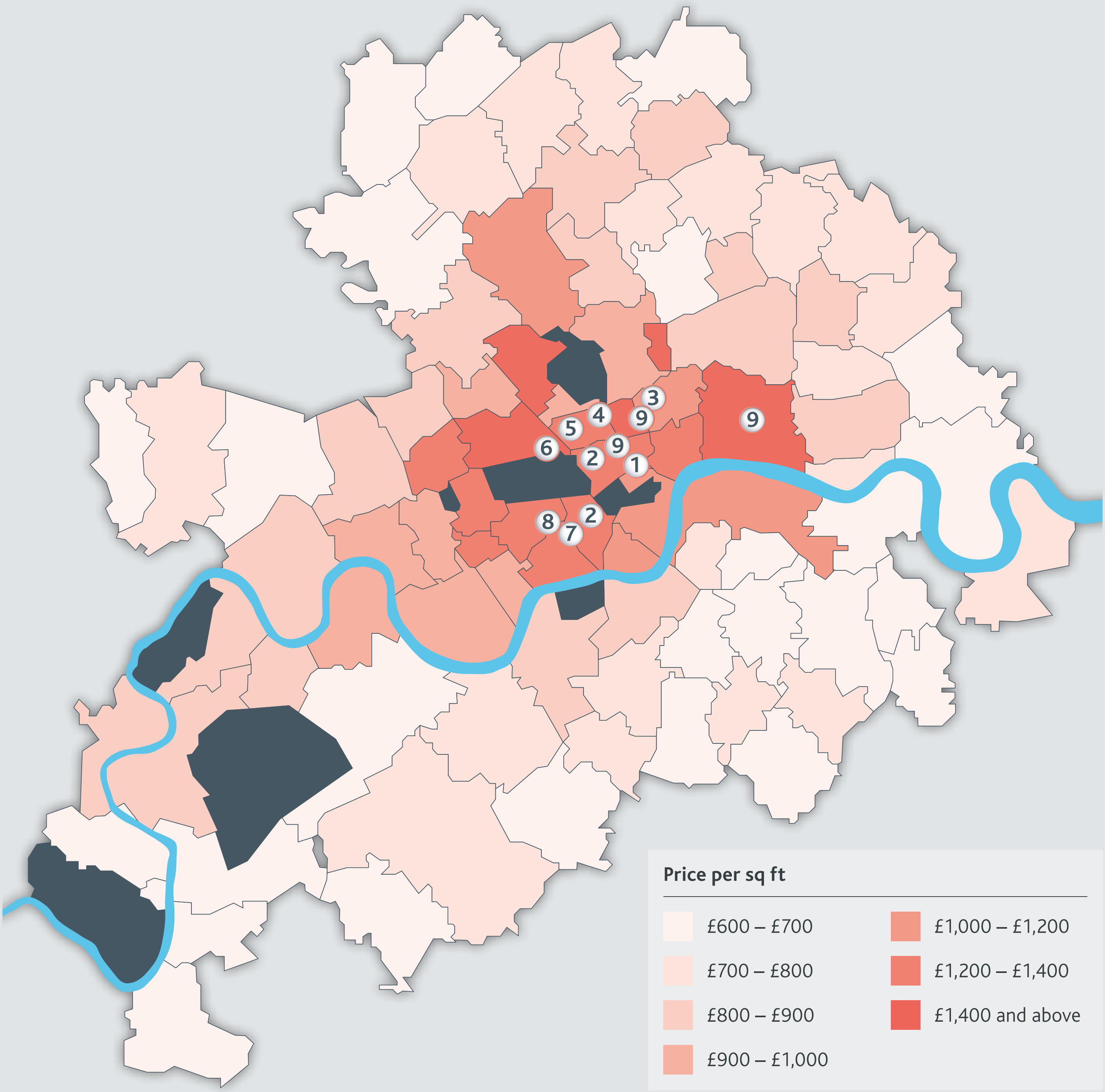
Meanwhile, the growing pressures on London's housing in recent decades have also pushed previous residents of PCL into neighbouring areas such as Fulham (SW6) and Maida Vale (W9). These areas are now priced as Prime but are not close enough to qualify as PCL. This pressure will also have had a cascading effect on the rest of London with successive generations pushed further afield.

Perhaps the easiest way to define PCL is with reference to location and the type of property. The value of the property is then a function of the two and represents the actual demand from buyers (and sellers' expectations). The map opposite shows that areas closer to Central London tend to have higher values on a per square foot basis. But analysis shows there is also variation around the type and quality of homes in the location. It finds that areas with higher proportions of period housing stock are more likely to have high values per square foot than areas with similar proximities to Central London but lower levels of period property. This suggests that PCL was effectively defined nearly two hundred years ago with the development of the Great Estates. It also finds the expansion of Prime areas has been heavily dictated by the subsequent development during the Victorian period.

However, more recent developments show that we are not entirely dependent on what happened hundreds of years ago. There are locations such as Kings Cross and South Bank where development has helped push pricing up to levels previously only found in PCL. There has also been a growing trend for residential development in areas that were more usually considered as somewhere to work rather than live such as Covent Garden and Victoria. That trend could become even more pronounced due to changing working practices since the pandemic.

What these more recent developments mean for definitions of PCL is less certain. While these locations may achieve PCL pricing, do they have the long-lasting attractiveness offered by the period properties in and around London's Great Estates. It is likely that only time will tell.

Defining prime: Central London residential price per sq ft



Established Prime Central London

Mayfair (W1J, W1K, W1S)
Knightsbridge and Belgravia (SW1W, SW1X)
South Kensington (SW7)
Chelsea (SW3, SW10)
Kensington (W8)
Notting Hill (W11)
St John's Wood (NW8 – houses only)

Emerging Prime Central London

Earls Court (SW5)
Covent Garden (WC1, WC2)
Marylebone (W1G, W1H, W1U)
Westminster, St. James's and Victoria (SW1A, SW1E. SW1H, SW1P, SW1Y)
Bayswater and Hyde Park (W2)
The City (EC1, EC2, EC3, EC4)
South Bank (SE1 – riverside only)

London's great estates

1. Crown
2. Grosvenor*
3. Bedford
4. Howard de Walden
5. Portman
6. Church Commissioners
7. Cadogan
8. Wellcome
9. City of London Corporation*

* multiple locations

Global demand, local markets

Prime Central London (PCL) attracts people from across the world, with demand for homes reflecting global political and economic trends. But local factors are also important. Each sub-market of PCL has its own appeal to different people. In recent years, domestic taxation has had a big impact on the market and could continue to do so in the future. This section looks at what makes PCL so attractive, the trends in who lives there, and what impact that has had on London's wider housing market.

Global city

PCL has evolved over hundreds of years and the people who live, work, and buy homes in the area have also changed. The decline of the upper classes following the first world war, destruction of buildings during the second, and high rates of taxation in the decades after, led to homes being knocked down or turned into offices. More recently, Middle Eastern and US buyers were active in the 1980s and 90s. Oligarchs took over in the 2000s. The 21st century has seen Far Eastern buyers become much more active in the new build sector. These trends demonstrate that PCL is subject to changes in global demand driven by politics and economics along with more domestic drivers such as taxation and policy decisions, but it continues to evolve to meet the needs of its residents and home owners.

There are multiple reasons why London is so attractive to property buyers from around the world. As a global city, it offers a wide selection of culture, entertainment, and heritage. It is an international centre of business with a working day that overlaps most other global cities. English is the main international business language. The robust legal framework makes it an attractive place to store and protect wealth.

Relatively low rates of taxation make it an attractive country in which to own property. Although stamp duty has been raised, the costs of holding high value property are much lower than rival global cities like New York, Paris, or San Francisco. Its success reinforces future demand and there is a well-established industry ready and willing to service the wants and needs of the global rich and elite. A survey by LonRes[1] reported 75% of London agents felt that the number of people looking to leave the capital had peaked, and 67% thought London house prices would outperform the rest of the country over the next five years. For the global community, London will remain an attractive place to live, work and play.

[1]LonRes Agent Survey May 2021

Turnover and taxation

The Prime Central London (PCL) housing market has been hard hit by changes to Stamp Duty Land Tax (SDLT) in recent years. In late 2014 there was the change from the "slab" approach, which applied a rate depending on the overall property value, to the current "slice" approach with increasing rates applying to the portion of the value above different price thresholds. This new "slice" approach led to much higher rates on properties valued over £1.1 million and contributed to a slowdown in the PCL market.

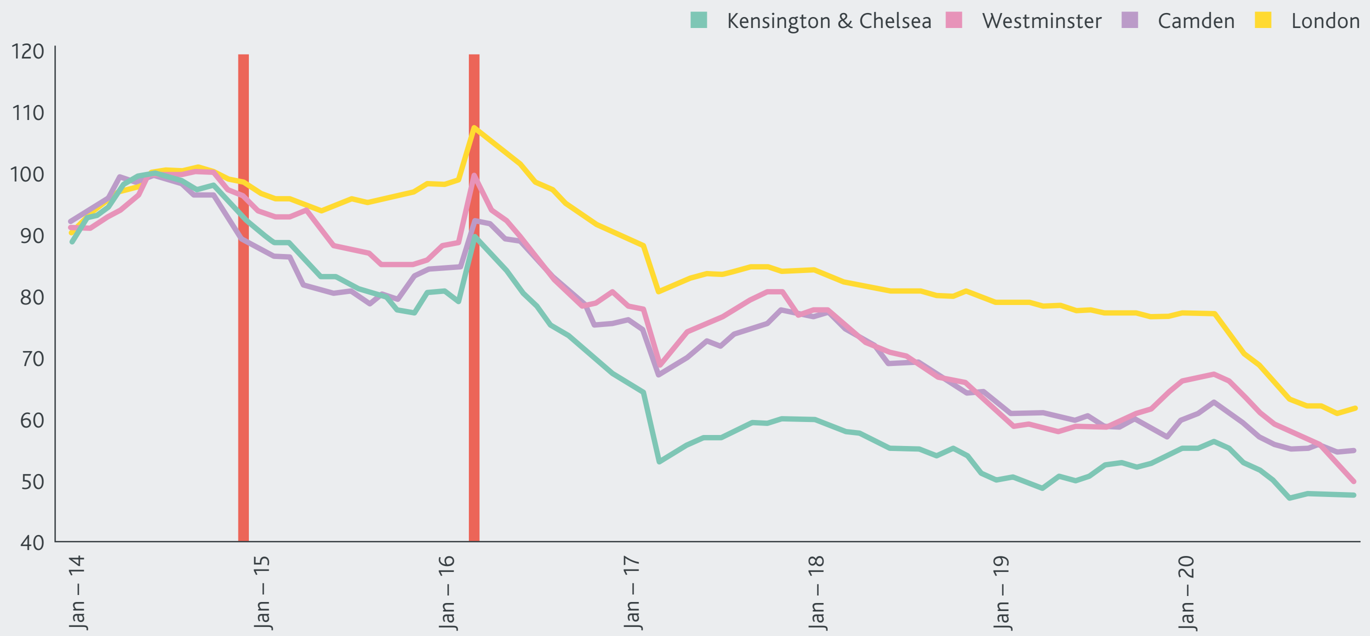
In April 2016, a 3% surcharge rate was introduced for additional purchases – typically second homes and investment properties. This led to a short-term spike in activity in March 2016 as buyers rushed to beat the deadline, but then contributed to further declines in transaction numbers. This year has seen a further tax change that will affect PCL with the introduction of the 2% surcharge for non-UK resident buyers. The impact of this latest change is unclear as it has coincided with the effects of the pandemic on overseas demand, but with so much wealth tied up in PCL property it is clear that it will continue to be a target for raising additional tax receipts.

13.3%

Central London boroughs* accounted for over 13% of England's residential SDLT receipts in 2019/20 from less than 1% of transactions

Source: HMRC (* Camden, Kensington and Chelsea, Westminster)

Figure 1 – Annual transactions indexed, June 2014 = 100



Source: HM Land Registry

Local markets

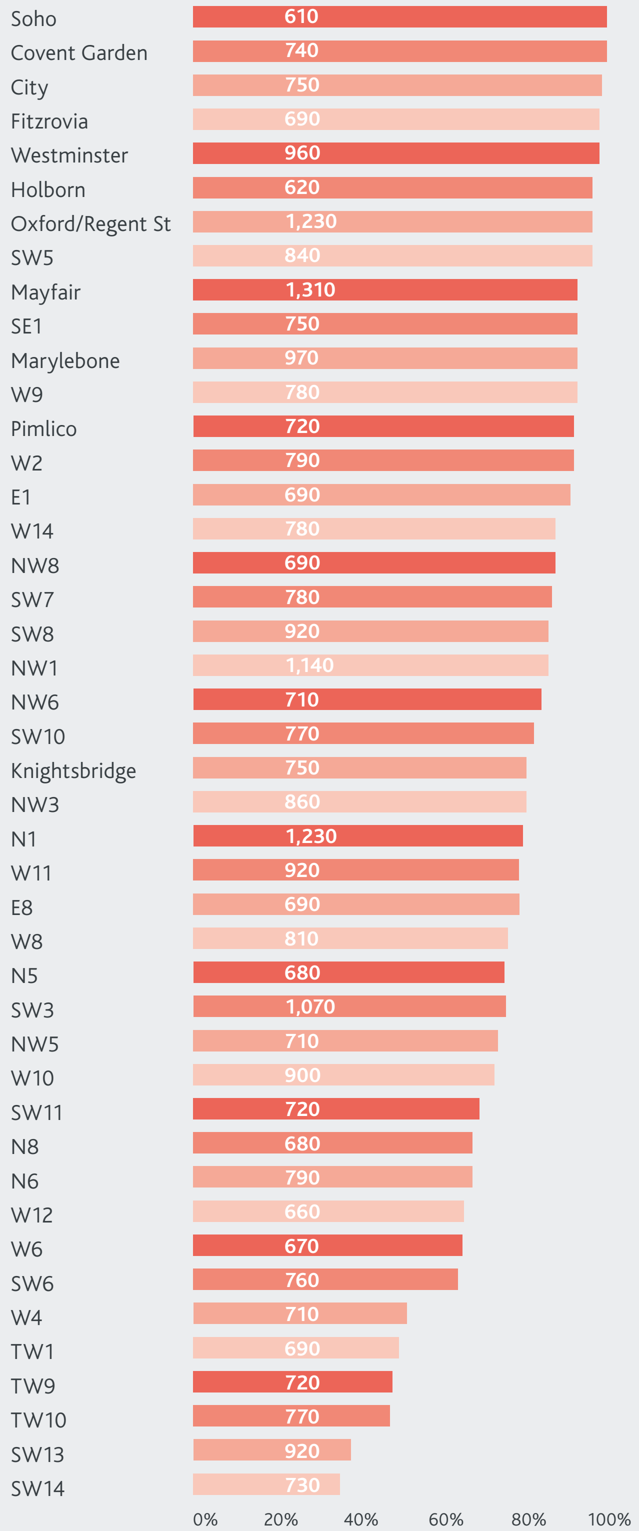
There are some factors that affect the national housing market and there are others that affect PCL as a whole. But there are some factors that only affect specific submarkets of PCL. These factors might include local schools (including international schools), transport links to other parts of London, or historical preferences now reflected by the type of shops and restaurants found in the local area.

The housing stock in individual submarkets can also play a part. While transactions have fallen significantly across PCL as a whole due to the stamp duty changes since 2014, our analysis shows a bigger fall in activity where there are higher proportions of flats in the local market. However, as always it is never this simple.

For example, both Mayfair and Earl's Court have similar proportions of flats (c.90%) in their local housing stock. But transactions in 2019 were down nearly 50% in Earl's Court and are relatively static in Mayfair, compared to 2014. A further clue to why this divergence has occurred can be seen by looking at the size of flats in the two markets.

The average size of flats sold in Mayfair is over 1300 square foot (sq ft) while the average size of sold flats in Earl's Court is only 850 sq ft. This reflects Mayfair's position as an aspirational investment for the seriously rich and for whom stamp duty is an inconvenience, while Earl's Court tends to attract investors looking to actively rent out their properties. They have been hit much harder by stamp duty changes.

Figure 2 – Flats as % of private housing stock



Source: MHCLG, VOA, Census

Future of Prime Central London

Prime Central London (PCL), has had to adapt and evolve to meet the changing needs of the rich and famous for hundreds of years. It now faces new challenges – not just thanks to Brexit and the immediate impacts of the global pandemic – but also longer-term issues like changing lifestyle preferences and climate change. This section looks at how it can rise to meet them while taking advantage of the new opportunities created by this unprecedented change.

Breaking the cycle

The discretionary nature of many property purchases in PCL means it responds quickly to changes in sentiment and is often the first market out of any downturn. The housing market was already firmly into its second half prior to the pandemic. House prices were rising fastest in the north of England and stagnant or falling in London. Despite predictions of a downturn, the pandemic appears to have continued the current market cycle. It has also added further complications with demand shifting away from urban areas. With both these factors and constrained international travel, PCL is one of the few housing markets that has not seen booming prices over the last six months.

The market cycle trend has not been kind to PCL in recent years. This is highlighted by Figure 3 which shows the ratio of house prices in Kensington & Chelsea to those in Kirklees in Yorkshire. The chart illustrates the relationship between PCL and the North of England over the past 25 years with a rising line representing a growing price premium for PCL and a falling line representing a falling price premium. The chart shows that PCL has been under-performing since 2015 but, compared to even the 2000 peak, the current ratio to a typical northern market is still relatively high. This raises the question of whether the pandemic will further reinforce the existing market cycle or can PCL bounce back when people return to cities in greater number and the global elite start travelling again.

The 'dotcom' boom of 2000 fed the first peak (1), with the trend then reversing as values grew strongly in the Midlands and North of England, along with them starting to fall in central London. The ratio bottomed out in 2005. The final stage of this cycle was for higher value markets in London and the South East to see a further burst of inflation in 2006-07 (2).

The global financial crisis in 2008 caused house price falls of around 20% across most UK markets (3). Central London fared slightly worse but started to bounce back much more quickly than other areas, and the ratio gradually climbed to a new peak of over 10:1 in early 2015 (4).

Since this point PCL values have been relatively weakened (5) by a series of policy changes and geopolitical events, underperforming other markets.

Figure 3 – Ratio of house prices: Kensington & Chelsea vs. Kirklees

Source: Land Registry (data is 12 months smoothed)

Risks on the horizon

In the immediate future, international travel will recover – from a very low trough – and more workers will return to their offices for at least some part of the week. This points to some level of recovery in demand from both discretionary buyers and those more driven by a 'need' to be in Central London. We also know that levels of wealth for the potential PCL buyer/investor demographic have grown significantly through the pandemic, so the ability to buy remains strong.

17hours

A new billionaire was minted every 17 hours on average over the past year.

+$5trillion

Altogether, the world's wealthiest are $5 trillion richer than a year ago.

Source: Forbes World's Billionaires List 2021

On the supply side, the continuing low inflation and low interest rate environment reduces the cost of holding valuable properties. But the Government appears to be open to significant spending to enhance the post-Covid recovery, potentially creating more inflationary conditions and increasing the appeal of alternative investments. Higher inflation could drive demand for real assets, but with the oft-mooted introduction of wealth taxes – which may be an easier political sell if framed as 'paying for the pandemic' – the drivers in favour of selling may grow.

The risk of a wholesale exodus from large cities is very slim, either in terms of living or working, despite some of the more sensationalist headlines in the past 15 months. But that does not mean that there will not be any changes or that these won't have an impact on Central London real estate.

Drivers of change

Changing lifestyle preferences might mean moving out of London to a completely rural location for some people, but equally it may just mean trying to find a flat with outdoor space or nearer to a park. We are unlikely to see the full impact of any shift until the pandemic is long behind us. Cluttons' agents have already noted lower demand for flats without gardens or balconies. The requirement for flats to be compliant with fire safety legislation, via an EWS1 form, has also dampened demand in this part of the market.

A longer-term issue is how suitable the existing building stock will be for its intended use over the rest of the century. Minimum energy efficiency standards (MEES) for letting property were introduced in 2018 (with the rules being tightened in 2020 for residential / 2023 for commercial). They already appear to have had an impact on buildings in Central London. EPC ratings across both sectors have improved over the past five years and, despite a high proportion of local period buildings, the percentage of potentially non-compliant buildings in the commercial sector has fallen to sit in line with the London average, as shown in Figure 4.

In the residential sector ratings overall are better but there has still been significant improvement over the past decade. The central boroughs have been more in line with the London average over this period, but the costs of bringing homes up to standard can be significant and may lead to inefficient homes losing value. This trend could accelerate if the emerging market for green mortgages and finance (i.e. cheaper rates for more efficient buildings) becomes more widespread.

Figure 4 – Proportion of EPCs not meeting minimum energy efficiency standard

Commercial	Proportion of properties EPC rated E or worse		
	2010/11	2015/16	2020/21
Kensington & Chelsea	51%	47%	18%
Westminster	44%	39%	15%
London	37%	33%	14%

Residential	Proportion of properties EPC rated E or worse		
	2010/11	2015/16	2020/21
Kensington & Chelsea	26%	16%	11%
Westminster	21%	15%	10%
London	23%	19%	10%

Source: MHCLG

Five key trends

The post-pandemic recovery is certain to bring change to the Prime Central London (PCL) market – creating new trends, accelerating some existing ones, and perhaps hampering others.

1

New development has been driving an eastward and southward expansion from the traditional core of PCL, but this could be slowed if working patterns don't return to the common pre-pandemic baseline. ONS surveys suggest over 90% of higher income employees expect a mix of homeworking and returning to their usual workplace. Without being based in the office five days per week, some employees may choose to live further from the city's employment centres.

2

Many PCL submarkets are home to established communities of various nationalities. The pandemic has probably seen London's population fall, with some estimates suggesting over half a million non-UK born residents have left the capital. The GLA's detailed analysis also highlights recent falls. The impact on the housing market will depend on whether any falls are temporary reactions to the pandemic or longer-term structural changes. For example, Brexit will limit free movement to and from EU nations and could make it difficult for some previous residents to return. This could trigger a shift in supply and demand in some locations.

3

High rise flats have also seen a separate fall in demand due to building safety concerns following the tragedy at Grenfell. This has led to uncertainty in valuations for homes in tall buildings, in some cases limiting the market to cash buyers. Areas with more houses and lower-rise mansion blocks could see more demand until these issues are resolved.

4

'Lockdown-proofing' is now a key consideration for many potential homebuyers. Access to nearby parks and green space, somewhere to set up a home office, and balconies or gardens, have all moved up the priority list, along with digital connectivity and energy efficiency. A recent survey by Nationwide found potential movers favouring less urban areas across all age bands. Within London, areas with higher proportions of suitable stock and more of a 'village feel' may become more sought after.

5

The pandemic may leave PCL with an excess of office and retail properties: Cluttons Q4 Office Market Review reported that take-up in Central London was 64% lower than the five-year average and availability was 24% higher. If demand for lower quality commercial stock remains low, property owners have the option of upgrading, or taking advantage of permitted development rights to convert to residential, potentially increasing the number of residential properties in some submarkets.

CLUTTONS

Cluttons LLP
2 Portman House
Portman Street
London W1H 6DU

T: 020 7408 1010
cluttons.com

For further details contact
Sophy Moffat
Head of research
T: 020 7647 7032
E: sophy.moffat@cluttons.com

2888 – 0621